Investigation of the Commission's Own Motion Regarding Innovative Utility Ratemaking Approaches that Promote Conservation and Efficiency Programs by Removing Disincentives that Exist Under Current Ratemaking Policies

05-UI-114
Survey Questions

Prepared by Wisconsin Public Service Corporation

PREAMBLE TO SURVEY RESPONSE

Wisconsin Public Service Corporation appreciates the opportunity to provide comments regarding innovative utility ratemaking approaches at a time when many changes are occurring in our society regarding the use of energy. Implementing effective energy policies will be critical for customers, utilities and the economy. It is very important to assess all viewpoints and options without preconceived conclusions and consider what changes in regulatory practices and policies will best address the carbon footprint concerns of today. Wisconsin Public Service Corporation looks forward to a continuing dialogue with the Commission on these important issues.

1. **Do the current rate structures of the electric and gas utilities in Wisconsin contain a net lost revenue and profit effect that is significant enough to discourage these utilities from developing and spending additional money on energy efficiency programs?**

   Current ratemaking policies do not recognize the underlying energy use changes occurring in society due to climate change and related carbon footprint concerns, nor do current ratemaking policies (predominantly based on flat rate designs) provide the correct price signal that would further encourage customers to adopt energy efficiency technologies and practices. As a societal issue, energy policy to further develop and spend additional dollars rests with government, not investor owned utilities.

2. **(Question for utilities) Is your utility likely to propose energy efficiency spending above current levels if any disincentive to do so is removed?**

   Innovative ratemaking approaches, most notably full revenue decoupling and lost revenue recovery which is limited to the effects of energy efficiency, may remove the disincentive for supporting additional energy efficiency but they do not create the incentive to propose additional energy efficiency spending above current levels. Additional energy efficiency spending proposals represent a direct increase to retail electric rates. The retail rate impacts and cost effectiveness of any such proposals, and how they add or hinder to existing programs and efforts, must be considered in a period of already rising prices.

3. **If disincentives are removed and the utility elects to spend higher than current amounts on energy efficiency, is it best for (a) for the utility to develop and implement the programs; (b) should that be done by Focus on Energy; (c) should it be done through a combination of the utility and Focus on Energy; or (d) should it be done by some other entity?**

   The ability to develop and implement additional utility programs varies from one utility to the next. Some utilities rely on and partner with the Focus on Energy programs to provide energy efficiency services for customers. Utility provided programs introduce duplication or conflict and confusion with the existing Focus on Energy programs.

4. **Do utilities currently have the resources to develop and implement additional energy efficiency programs?**

   The ability to develop and implement additional energy efficiency programs varies from utility to utility, as some utilities rely and partner with the Focus on Energy programs while other utilities provide energy efficiency services directly to their customers. Wisconsin Public Service believes societal energy issues should be addressed by government and supports the Focus on Energy programs as the best approach to provide uniform and consistent energy efficiency programs and options to the residents of Wisconsin. Wisconsin Public Service works closely with its customers to make them aware of available services and programs that are offered by Focus on Energy.

5. **Should a decoupling mechanism consider only the effects of additional energy efficiency spending or should it also include the effects of other factors such as the economy and weather on actual vs. forecasted sales? If yes, please explain why?**

   Mechanisms that consider only the effects of additional energy efficiency spending are not true decoupling mechanisms. Instead, these mechanism seek to recover lost revenues from a specific cause, most often energy efficiency. Mechanisms that seek to provide the utility the opportunity to recover its costs and earn an authorized return in an environment of changing and decreasing energy use is full revenue decoupling. Recent changes in society regarding energy and its use due to climate change and carbon footprint concerns have made it increasingly difficult to set rates that allow the utility the opportunity to recover its fixed costs. Traditional ratemaking is not able to address this issue. The lost revenue recovery mechanism does recognize these larger societal changes.

6. **If you answered yes to Question #5, should it be necessary for a utility to propose additional energy efficiency spending before it could see, recovery of any lost revenues due to other factors?**

No. It is necessary to recognize that there are two separate issues to be addressed. Full revenue decoupling is a ratemaking policy issue to recognize the changes in energy use and how that affects the utility. It is an energy policy issue whether energy efficiency should have an expanded role in an society that is changing its views on energy and how it is used.

7. If a decoupling mechanism considers only the effects of additional energy efficiency spending, but due to weather, economic or other factors the utility is either earning its authorized ROE or is within some range of its authorized return, should it still recover lost revenues?

As noted above, decoupling and lost revenue recovery have different purposes and are not the same. A full revenue decoupling mechanism by definition addresses all variances to the sales forecast as approved in the rate case whereas lost revenue recovery addresses only those sales lost due to energy efficiency programs. A properly designed full revenue decoupling will be symmetrical so that customers will see adjustments both up and down for variances from the approved rate case forecast. Disallowing a lost revenue recovery mechanism if the utility is earning its ROE or is within a bandwidth of ROE appears to be a disincentive to deal with the mechanism at all. In practical terms, the cost and time to verify what is lost due to utility induced energy efficiency is already a significant barrier to the use of the lost revenue recovery mechanism.

8. **Please provide what you believe to be the key components of a decoupling mechanism**.

A full revenue decoupling mechanism is one that is (1) simple and transparent, based on existing rate case data and processes and (2) allows for symmetrical treatment of variances, plus or minus. Frequent adjustments are preferred to annual adjustments or adjustments in subsequent rate cases.

9. Please provide examples of ratemaking mechanisms other than decoupling that could incent utilities to pursue additional energy efficiency spending at a reasonable cost to ratepayers.

A very different type of mechanism is Duke's "Save-a-Watt" mechanism that capitalizes and gets a return of and a return on energy efficiency projects at the equivalent cost of supply side generation.

10. Should all customer classes be included in any mechanism that is implemented to encourage utilities to promise additional energy efficiency spending? Why or why not?

No. Large industrial customers should not be included. These customers are already very aggressive in seeking out energy efficient technologies and processes in order to remain competitive in the market place.

11. **If your answer to Question #9 is no, should additional energy efficiency programs only be designed to benefit only participating customer classes? Why or why not?**

Yes. One fundamental ratemaking principle is to avoid cross subsidies between customer classes.

12. **Do you foresee controversy in determining the amount of reduced kWh sales caused by additional energy efficiency spending and the dollar margin on the reduced sales used to determine the under recovered amount to be included in rates? Why or why not?**

Yes. It is very time consuming and expensive to determine the true impact of an energy efficiency program for reporting purposes even without further monetary consequences to the utility. Issues of the effects of other variables in the environment (such as the economy, lifestyle changes and weather), naturally occurring conservation, free ridership, persistence and pre- and post-measurement techniques will become even more under review and analysis. There is likely to be a significant time lag to ultimately determine what was attributable solely to the energy efficiency program vs. other environmental variables.

13. **Considering the lag time between the design and the implementation of energy efficiency programs and that utilities file regularly for rate reviews, would the following alternative to decoupling be useful in removing disincentives to utilities promoting these programs? For programs that a utility is proposing prior to a rate case filing an estimate of reduced sales would be made and the test year sales forecast would be reduced accordingly. For programs developed and implemented during the utility's biennial year, a decoupling mechanism could be used to adjust for the impact of these programs until the next rate period (it would be likely that the lag time in implementing programs would make revenue adjustments relatively small).**

No. For the reasons given above, what energy efficiency adjustments to include during a rate case process would be just as cumbersome and slow before the implementation of a program as afterwards. Further, it cannot be presumed that subsequent adjustments for energy efficiency impacts would be small because at the very least, there will be variation at an aggregate program

level between actual results and goals. Market conditions and customer response to any particular program is not easily predictable.

14. Is revenue decoupling illegal retroactive ratemaking? Why or why not?

No. Revenue decoupling is not illegal retroactive ratemaking, provided a prospective formulaic approach is adopted in rate orders. In this sense, revenue decoupling will not disturb prior orders or disallow charges or benefits previously ordered. The decoupling adjustments would be adopted prospectively—through the mathematical formula set in the rate order—and would thus not constitute retroactive ratemaking by the Commission. In this way, decoupling adjustments would be similar to the purchased gas adjustment ("PGA") that gas utilities have used for decades.

Please see Attachment A.

15. Are you aware of mechanisms other states use to incent additional energy efficiency on behalf of their utilities that you believe would be successful in Wisconsin? If so, please identify those states?

Various states have versions of full revenue decoupling or lost revenue recovery mechanisms. A very different type of mechanism is Duke's "Save-a-Watt" mechanism that capitalizes and gets a return of and a return on energy efficiency projects at the equivalent cost of supply side generation.

16. Does a decoupling mechanism represent a reduction in risk to the utility? If so, should that be reflected in the authorized return on equity?

No. There is neither a reduction of risk nor a shift of risk when adopting a decoupling mechanism or a lost revenue decoupling of mechanism. Under either mechanism, the utility must still manage it costs to within budget to achieve ROE targets, continues to have an obligation to serve and is subject to unforeseen events, outages, legislation, environmental rules and regulation and acts of God that all could cause a utility to not earn its ROE.

17. What process should the Commission use to establish the parameters of ratemaking approaches that promote energy efficiency; i.e. should the Commission approve utility-specific plans or establish guidelines for implementation in rate cases?

The Commission must first recognize that decoupling and an increase in energy efficiency spending are two separate issues. One is ratemaking policy and the other is energy policy. There is no agreement between utilities on these issues in general and the Commission should provide the greatest flexibility for each utility to pursue a course of action that each deems best for its business case.

18. Are there important differences between gas and electric utilities to be considered when designing an incentive mechanism?

No. The underlying theory to use a full revenue decoupling mechanism as the new means to establish cost recovery is applicable and appropriate to both electric and gas. A lost revenue recovery mechanism is also applicable to both.

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Attachment A to Question 14

I. Wisconsin's Retroactive Ratemaking Rule Does Not Ban Decoupling

The "rule against retroactive ratemaking" is codified in Wis. Stat. § 196.37(1), which requires the PSC to set rates only on a prospective basis. This section states:

> If, after an investigation under this chapter or ch. 197, the commission finds rates, tolls, charges, schedules or joint rates to be unjust, unreasonable, insufficient or unjustly discriminatory or preferential or otherwise unreasonable or unlawful, the commission shall determine and order reasonable rates, tolls, charges, schedules or joint rates to be imposed, observed and followed in the future.

Wis. Stat. § 196.37(1) (emphasis added). [1]

"[U]nder § 196.37(1) the PSC is authorized [during ratemaking proceedings] to evaluate a just and reasonable rate only for services that will be provided in the future; the agency may not, with the exception of extraordinary casualty loss, adjust that rate to take into account an over or under valuation of services provided in the past." *CenturyTel of the Midwest-Kendall, Inc. v. PSCW*, 2002 WI App 236, ¶ 31, 257 Wis.2d 837, 653 N.W.2d 130. In other words, even if the rate set is a prospective one, the PSC may not include in that rate an adjustment that reflects prior gains or losses against prior rates. "To permit the PSC ***to condition a rate order*** on refund of sums collected ***under previously established permanent rates*** would directly violate

[1] There are exceptions to the rule, none of which apply here because we conclude that the rule does not apply to decoupling. *Wis. Envtl. Decade v. Public Service Comm.*, 98 Wis.2d 682, 698, 298 N.W.2d 205 (Ct.App. 1980) (upholding a rate increase that allowed recover of extraordinary losses caused by a severe ice storm); *Madison Gas & Electric Co. v. Public Service Comm.*, 150 Wis.2d 186, 197, 441 N.W.2d 311 (Ct.App. 1989) ("[A]voiding an overcollection [of taxes] under future service rates is not retroactive ratemaking"); *Wis. Public Service Corp. v. Public Serv. Comm.*, 156 Wis.2d 611, 457, N.W.2d 502 (Ct.App. 1990) (finding that the PSC could adjust the utility's rate of return downward because the utility acted imprudently in failing to protest tax payments); *GTE North Inc. v. Public Service Comm.*, 176 Wis.2d 559, 500 N.W.2d 284 (Wis. 1993) (finding that the PSC can order a refund under § 196.37(2) if the utility violates the filed rate doctrine).

the rule against retroactive ratemaking." *Friends of the Earth v. Public Service Comm.*, 78 Wis.2d 388, 412, 254 N.W.2d 299 (Wis. 1977) (emphasis added).

For decades, the PSC has authorized natural gas utilities to collect their costs of purchasing natural gas supplies for their system customers through purchased gas adjustment clauses. A PGAC contains a formula designed to allow the utility to collect its purchased gas costs, nothing more and nothing less. The formula trues up the utility's rates prospectively to reflect its actual gas costs in the recent past. As the PSC describes it,

> What the interplay of the rate case, the PGA and the true-up produces is a rate which is in effect for a period between true-ups (effective rate) which is composed of:
>
> 1) The base average gas cost components, calculated during the rate case;
>
> 2) The utility's margin;
>
> 3) The PGA factors, calculated at each PGA and changing with each PGA; and
>
> 4) The true-up adjustment factors, calculated at the true-up filing date and remaining constant throughout the year.
>
> The true-up adjustment factor, when it is a surcharge, acts as an increase in the base average cost of gas which was established during the rate case. Of course, if it is a negative factor, it acts as a decrease in the base average cost of gas. And, ***since the PGAC is a rate schedule with primarily prospective application, and the true-up mechanism is a part of that schedule, the PGAC with the true-up does not constitute unlawful retroactive ratemaking and is not a violation of [Wis. Stat. § 196.37].***

See, e.g., *Re Natural Gas Distribution Utilities in Wisconsin*, Docket No. 05-GI-102 et al. (Feb. 23, 1989) (emphasis added).

The Wisconsin Supreme Court has not addressed whether, in general, adjustment clauses comply with the rule against retroactive ratemaking. *See Wisconsin's Envtl. Decade, Inc. v. Public Service Comm.,* 81 Wis. 2d 344, 352 n.4, 260 N.W.2d 712 (1978).[2] The legislature in 1983 prohibited automatic electric fuel

[2] In that *Decade* case, the court held that an "expanded" fuel adjustment clause which included additional cost items besides fuel costs violated Wis. Stat. § 196.20(2), which requires an opportunity for hearing before the PSC may authorize a rate increase. Some parties may argue that a decoupling mechanism would also run afoul of that statute unless it incorporates an opportunity for hearing prior to any adjustment that would constitute an increase in the utility's rates. We believe this is incorrect, because none of the reasons the *Decade* court cited for the unlawfulness of an expanded fuel adjustment clause applies to decoupling, which is limited to one component of the

adjustment clauses "which [permit] the electric public utility to recover in rates, without prior hearing and order of the commission, an increase in costs incurred by the electric public utility." Wis. Stat. § 196.20(4)(a)1. Otherwise, however, automatic adjustment clauses have been used by utilities in Wisconsin since at least 1918. *Id.*, 81 Wis. 2d at 347. These include the PGAC, which, according to the *Natural Gas Distribution Utilities* order, has been in use since the late 1970's. These facts, coupled with the legislature's express prohibition of certain fuel adjustment clauses, strongly imply that adjustment clauses in general do not violate the rule against retroactive ratemaking. Indeed, many state courts and commissions have reached the same conclusion as the PSC that the rule does not apply to adjustment clauses because they are part of the utility's rate schedule. *E.g., Chicago v. Illinois Commerce Commn.,* 150 N.E.2d 776 (Ill. 1958); *Norfolk v. Virginia Elec. & Power Co.,* 90 S.E.2d 140 (Va. 1955); *Peoples Counsel v. Public Service Comm.,* 472 A.2d 860 (D.C. Ct. App. 1984); *Washington Util. & Transp. Commn. v. Puget Sound Power & Light Co.*, 99 P.U.R.4th 305 (Wash. U.T.C. 1988) (and cases cited at n.8). *But see Central Vermont Public Service Corp.,* 473 A.2d 1155 (Vt. 1984).

As with the PGAC, a revenue decoupling mechanism prospectively trues up a utility's rates to ensure that the utility recovers its approved gross revenue margin, nothing more and nothing less. Like the PGAC, revenue decoupling mechanism "is a rate schedule with primarily prospective application, and the true-up mechanism is part of that schedule." *Natural Gas Distribution Utilities, supra.* In neither case does the PSC adjust rates to take into account an over or under valuation of services provided under past permanent rates. To the contrary, the mechanisms work in an automatic fashion to ensure that utility does not over or under recover components of its approved rates.

The primary purpose of the rule against retroactive ratemaking is to "'prevent a company from recouping losses caused by errors in judgment or through company mismanagement. Without this rule there would be no incentive for efficient management.'" *Wisconsin's Envtl. Decade, Inc. v. Pub. Serv. Comm'n,* 98 Wis. 2d 682, 699, 298 N.W.2d 205 (Ct. App. 1980). Like the PGAC, which recognizes that a utility is a price taker for the natural gas commodity, revenue decoupling does not vitiate the purpose for the rule against retroactive ratemaking. Decoupling recognizes that variations in sales result from causes beyond the utility's control – including weather,

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utilities rates (revenues) and incorporates a very simple formula. Decoupling therefore would not "defuse, in part public awareness of changes in utility rates, and … reduce public scrutiny of these changes." 81 Wis. 2d at 349. Unlike such items as labor costs, the utility does not have control over its revenues, which are instead affected mostly by weather, the economy and energy efficiency efforts undertaken by Focus on Energy. *Id.* Decoupling does not eliminate or even reduce the utility's incentive to economize and seek greater efficiency, because the utility must still control its non-fuel costs in order to profit. *Id.* For these reasons, decoupling does not "undermine the mandatory hearing requirement embodied" in § 196.20(2). 81 Wis. 2d at 351. Therefore, we have concluded that a decoupling mechanism with automatic trueups for revenue variations does not require a hearing opportunity for every adjustment that constitutes a rate increase. *Accord Wisconsin's Envtl. Decade, Inc. v. Public Service Comm.,* 105 Wis. 2d 457, 461, 313 N.W.2d 863 (Ct. App. 1981) (inclusion of nuclear fuel in fuel adjustment clause authorized because it is not subject to the utility's cost control); 70 Wis. Op. Atty. Gen. 108 (1981) (granting utility rate increases under automatic fuel adjustment clauses without hearings probably does not violate § 196.20(2)).

the economy and energy efficiency efforts – and ensures the utility's recovery of a set level of revenue net of fuel or gas costs. But the utility remain fully responsible for controlling its costs of providing service, and therefore the profits on its revenues. A utility with a decoupling mechanism will still have the strongest of incentives to manage their non-fuel/non-gas costs, which affect its ability to earn its authorized rate of return.

Revenue decoupling (and the PGAC) can also be validated under Wisconsin law because the mechanism prospectively renders a portion of a utility's rates subject to further review and adjustment. The Commission has broad authority to issue conditional orders and interim rates. *E.g., CenturyTel of the Midwest-Kendall*, 2002 WI App 236, ¶ 32 ("[I]f [an] interim order is conditioned on the possibility that a refund might be required, the PSC does have the authority to order a refund in the final order because in this situation 'the PSC has not fully exercised its ratemaking power until such interim rates are re-evaluated in the final order.'").

II. Other State Commissions Have Determined That Decoupling Does Not Constitute Retroactive Ratemaking

A. *Illinois*

In its February 7, 2008 Final Order (*Final Order*) in the PGL/NSG rate cases. The ICC rejected retroactive ratemaking challenges to Rider VBA, which was the decoupling mechanism proposed by those two WPSC affiliates.[3] Staff and Intervenors in the PGL/NSG rate case argued that the Rider VBA improperly permitted monthly and annual rate adjustments after rates were established in the general base rate case, and that such true-ups would be made using comparisons of actual versus prior data, all in violation of the rule against retroactive ratemaking. *Final Order* at 142.

In rejecting these arguments, the ICC relied on *United Cities Gas Co. v. ICC*, 163 Ill. 2d 1 (1994), where the Illinois Supreme Court held that the ICC's "refund of certain gas costs that occurred in the context of a PGA reconciliation proceeding" "did not disturb any of its prior orders or disallow charges or benefits it had previously approved … the ICC did not make adjustments to, or rescind orders entered in earlier proceedings so as to retroactively deny the utility any revenues or benefits it had previously allowed."

The ICC concluded with respect to PGL and NSG's proposed Rider VBA that:

> Upon careful and studied consideration, the Commission concludes that Rider VBA presents no violation of the rule against retroactive ratemaking. Rider VBA does not disturb either this order or any of the Commission's prior orders. Nor does it disallow charges or benefits previously ordered. The adjustments and true-ups under Rider VBA do nothing

[3] WPSC's corporate parent, Integrys Energy Group, Inc., acquired PGL and NS through a merger in 2007.

> to alter or de-stabilize the revenue requirement established here. The rates are what they are. Nor does Rider VBA disturb any of the underling revenue formula components and decisions thereon arrived at through the traditional rate-making process in this proceeding. Nor does Rider VBA suggest that the rates are in any way excessive or insufficient. This order establishes the rate that the Utilities are required to charge and pursuant to Rider VBA the Utilities would only receive the margin revenues that the Commission intends to be recovered. It is not the rates, but the computation of these rates that varies.

Final Order at 144-45 (emphasis added).

B. *Washington*

In 1991, the Washington Utilities and Transportation Commission ("WUTC") similarly found that decoupling "does not involve retroactive ratemaking," but instead "is similar to energy cost adjustment clauses because it sets up a deferred account allowing a reconciliation of revenue and expenses that would be subject to hearing and review." *Re Puget Sound Power and Light Co.*, WUTC Docket No. UE-901184-P (3rd Suppl. Order Apr. 1, 1991). The WUTC stated that "A cost adjustment clause is prospective and not retroactive. It authorizes a fixed mathematical formula and is valid against a charge of retroactivity." *Id.*, *accord Puget Sound Power and Light Co.*, WUTC Docket No. U-81-41 (6th Suppl. Order, Dec. 19, 1988). The WUTC further noted in *Puget Sound* that:

> [simply because] an element of the rate involves a factor for actual historical performance does not make the rate retroactive. The potential evil in such a rate is not that it is retroactive, which technically speaking it is not, but that as an adjustment to reflect actual performance it might move the company toward a guaranteed achieved financial performance. All ratesetting involves a review of historical performance, whether it is an overall review of complete company operations or whether it is a single- or few-item analysis of the sort here involved. A general rate case involves the same sort of "true-up" to rates, except that it considers the full panoply of relevant factors. Other expense items are routinely authorized in rate making, such as unusual weather-related expense adjustments and rate case expenses.

Id. The WUTC's *Puget Sound* decision relied upon a Mississippi Supreme Court case with a similar holding related to gas adjustment clauses. *United Gas Corp. v. Mississippi PSC*, 127 So.2d 404 (Miss. 1961).

C. *North Carolina*

In a recent North Carolina Utilities Commission ("NCUC") decision approving a decoupling mechanism over retroactive ratemaking objections, the Commission indicated that the retroactivity "prohibition applies to 'fixed general' rates and is not violated when a formula that has been approved as part of a utility's rate structure is used to true-up an estimated rate." *Re Piedmont Nat. Gas. Co., Inc.*, 246 P.U.R.4th 287 (Nov. 3, 2005) (finding that the decoupling mechanism is "not a 'fixed general' rate but rather should be approved as a formula rate").

The Commission also found that "the North Carolina Supreme Court has authorized use of an adjustment clause as a part of a public utility's published rate schedules. Such an adjustment clause may be 'nothing more than a relatively simple mathematical formula by which the utility computes the additional charges or credits' that are added to the customers' monthly bills. Once approved, the clause or formula can operate so as to permit monetary additions or subtractions to bills without the necessity for a new rate filing or hearing. ***The [decoupling mechanism] is such a mathematical formula.***" *Id.* (emphasis added) (citations omitted).